

Sector: Capital Goods
Result Update

	Change
Reco: Buy	↔
CMP: Rs. 265	
Price Target: Rs. 325	↔

↑ Upgrade ↔ No change ↓ Downgrade

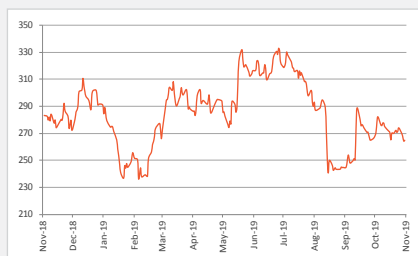
Company details

Market cap:	Rs. 6,812 cr
52-week high/low:	Rs. 341/230
NSE volume: (No of shares)	3.3 lakh
BSE code:	532714
NSE code:	KEC
Sharekhan code:	KEC
Free float: (No of shares)	12.4 cr

Shareholding (%)

Promoters	51.6
FII	8.1
DII	27.1
Others	13.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	0.0	-9.7	-9.6	-6.7
Relative to Sensex	-7.8	-18.7	-15.7	-20.0

Sharekhan Research, Bloomberg

KEC International Limited (KEC) revenues grew by 17% y-o-y driven by strong execution in T&D business (domestic and international), where revenue grew by 30%, despite multiple challenges. SAE revenues doubled y-o-y due to three large order executions and it will continue to contribute strongly for next couple of quarters. The non-T&D comprising railways, civil and other businesses came lower by 3% y-o-y, wherein railways saw a 35% y-o-y growth, whereas the civil segment saw a decline due to muted industrial capex. Blended operating margins remained flat at 10.5% y-o-y. Healthy operational performance along with lower tax outgo resulted in strong net earnings growth. The management reiterated 15-20% y-o-y growth in revenue with stable OPM for FY2020. A healthy order backlog of Rs. 18,000 crore and L1 orders worth Rs. 5,000 crore, provides revenue visibility of 1.5x TMM consolidated revenue. The outlook for KEC's business segments, viz. T&D and railways remains favourable. The management stated that order inflow guidance of Rs. 17,000 crore for FY2020 may be difficult to achieve and may be revised in the subsequent quarter. Although the green energy corridor does provide a healthy order inflow visibility, the fructification of the same remains a key monitorable. However, execution in FY2020 is not expected to be materially affected owing to KEC's strong order backlog. In the railways segment, order momentum remains strong and the company has entered into new sub-segment (railways over bridges, metro), which will further boost railway revenues. We have fine tuned our earnings estimates for FY2020-FY2021 factoring corporate tax rate cut. We maintain a Buy rating on the stock with an unchanged PT of 325.

Key positives

- Strong growth in T&D and railways businesses.
- Management reiterated its guidance for 15-20% revenue growth with stable OPM
- Railways' execution remained strong, (revenue increased +34.7% y-o-y)

Key negatives

- The management stated that order inflows may fall short of its yearly guidance of Rs. 17,000 crore due to slow tendering.
- Civil segment revenue declined due to muted industrial capex

Our Call

Maintain Buy with an unchanged PT of Rs. 325: KEC has a strong overall order backlog of Rs. 18,000 crore, which led to the management reiterating its revenue guidance of 15-20% for FY2020, led by scalability in the non-T&D business and stable execution in the T&D segment. Given a healthy order backlog and KEC's ability to ramp-up execution, we expect revenue and earnings to clock CAGRs of 15% and 22%, respectively, over FY2019-FY2021E. We have fine-tuned our earnings estimates for FY2020-FY2021 factoring corporate tax rate cut. We reiterate our Buy rating on the stock with an unchanged price target (PT) of Rs. 325.

Key Risks

Slowdown in tendering activities, especially in T&D and railways.

Valuation (Consolidated)

Particulars	Rs cr			
	FY18	FY19	FY20E	FY21E
Revenue	10,058	11,001	12,656	14,633
OPM (%)	10.0	10.5	10.4	10.4
Adjusted PAT	460	486	608.8	723.1
% YoY growth	51.1	5.7	25.2	18.8
Adjusted EPS (Rs.)	17.9	18.9	23.7	28.1
P/E (x)	14.8	14.0	11.2	9.4
P/B (x)	3.4	2.8	2.4	2.0
EV/EBITDA (x)	8.2	7.2	6.9	6.2
RoNW (%)	25.7	21.9	23.1	23.1
RoCE (%)	25.1	26.4	24.2	23.3

Source: Company, Sharekhan Estimates

Execution remains strong: KEC International Ltd's (KEC's) revenue grew by 17% y-o-y, driven by strong execution in the T&D business (domestic and international), with revenue rising 30%. The SAE business reported healthy growth of 94% y-o-y on the back of three large order executions and it will contribute strongly to SAE revenue for the next couple of quarters. The non-T&D business, comprising railways, civil and other businesses declined 3% y-o-y, wherein railways registered a 35% y-o-y growth, whereas the civil segment saw a decline due to muted industrial capex. Blended operating margins remained flat at 10.5% y-o-y. Healthy operational performance along with lower tax outgo resulted in strong net earnings growth.

Order book remains healthy: KEC's order backlog remains strong at Rs. 18085 crore, providing a revenue visibility of 1.5x TTM consolidated revenue. Moreover, KEC stands as the lowest bidder for approximately Rs. 5000 crore worth of projects in T&D, railways and civil. Further, in the Green Energy Corridor, the tendering pipeline stands at Rs 34,000 crore and provides healthy order inflow visibility for KEC, but fructification of the same remains a key monitorable. Globally, KEC is witnessing traction in Bangladesh and the SAARC nations. Order inflows in these geographies are likely to gain momentum in H2FY2020. Traction in the MENA region continues, but Saudi Arabia has been seeing fierce competition and hence the management believes that order inflows from this region might slow down. Hence, KEC is trying to diversify into new countries in the MENA region. For SAE Towers, all three major EPC projects on its book are currently being executed. There is one more auction up-coming in Brazil in December and KEC will be bidding for the project.

Key conference call highlights

- ◆ **Guidance maintained:** The management reiterated its guidance for 15-20% revenue growth with stable OPM and KEC is expected to deliver strong growth on increased scalability in non-T&D business and stable execution in the T&D segment.
- ◆ **Order backlog and L1 positions:** The company's current order book stands at Rs. 18,085 crore and L1 in orders worth Rs. 5,000 crore, which includes orders from PGCIL and state electricity boards and railways. Further, in the Green Energy Corridor, the tendering pipeline stands at Rs 34,000 crore that provides a healthy order inflow visibility but fructification of the same remains a key monitorable.
- ◆ **Order inflows may lag guidance:** Order inflows may fall short of guidance short of its yearly guidance of Rs. 17,000 crore due to slow tendering. However, execution during FY2020 is not expected to be materially affected due to its strong order backlog.
- ◆ **Railways:** In the railways segment, KEC has entered into new sub-segments such as railway over-bridges, metro civil works and the Regional Rapid Transit System (RRTS), which is in line with the company's strategy to expand its presence in the Railways segment and its civil segment. The company is expecting 20-25% growth in railways revenue for FY2020.
- ◆ **Civil:** KEC has received its first order from defence wherein the scope of work includes commercial-cum-residential construction work and expects the opportunity size to be large in defence with similar works. In the civil segment, the management expects to grow its revenue by ~25% y-o-y.
- ◆ **Saudi receivables:** There are no overdues from Saudi Arabia as of now and till date the company has received Rs. 600 crore. Going ahead, the retention money would accrue as and when the contract is completed.
- ◆ **Borrowings:** The company slashed borrowings by almost Rs. 400 crore and the debt is in line with its guidance for average borrowings of Rs. 2,500 crore.
- ◆ **Tax rate for FY2020:** For FY2020 tax rate will be at 28.5%.

Results					Rs cr
Particulars	Q2FY20	Q2FY19	YoY	Q1FY20	QoQ %
Net Sales	2,809	2,408	17%	2,412	16%
Net raw material	1,390	1,206	15%	1,116	25%
Erection and subcontracting charges	554	509	9%	572	-3%
Employee cost	275	207	33%	222	24%
Other Expenditure	296	233	27%	252	18%
Operating Profit	294	253	16%	251	17%
OPM %	10.5%	10.5%		10.4%	
Other Income	4	2	110%	3	32%
Depreciation	35	30	14%	37	-5%
Interest	82	77	7%	80	3%
PBT	181	148	22%	138	31%
Tax Expenses	41	51	-19%	49	-16%
Tax rate %	23%	35%		36%	
Net Profit before exceptional items	139	96	44%	89	57%
Exceptional items	-	-		-	
Net Profit after exceptional items	139	96	44%	89	57%
NPM %	5.0	4.1		3.7	

Source: Company Data, Sharekhan Research

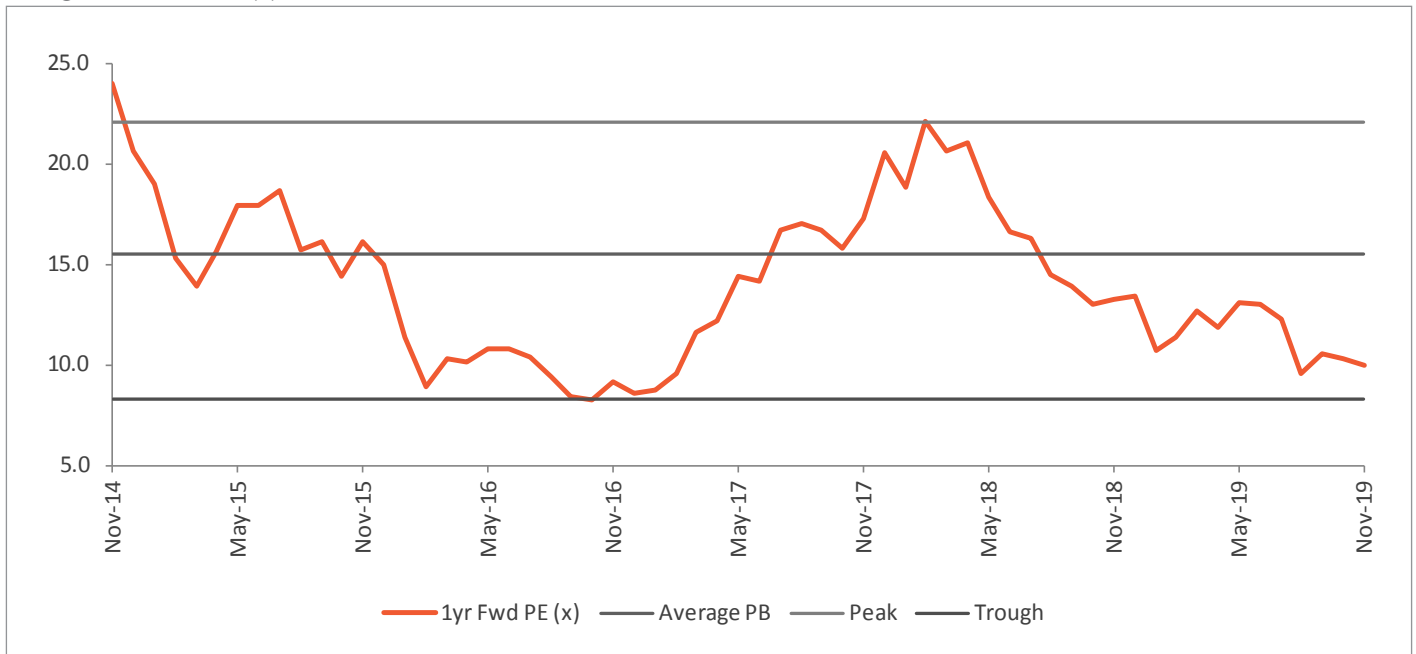
Outlook

T&D, railways to see sustained order inflows: The outlook for KEC’s business segments, viz. T&D and railways remains favourable. The Green Energy Corridor and projects from state electricity boards provide strong visibility of order inflows for KEC but fructification of the same remains a key monitorable. In railways, order momentum is expected to continue, led by the domestic electrification drive. The management reiterated its guidance for 15-20% revenue growth with stable OPM and KEC is expected to deliver strong growth on increased scalability in non-T&D business and stable execution in the T&D segment.

Valuation

Maintain Buy with an unchanged PT of Rs. 325: KEC has a strong overall order backlog of Rs. 18,000 crore, which led to the management reiterating its revenue guidance of 15-20% for FY2020, led by scalability in the non-T&D business and stable execution in the T&D segment. Given a healthy order backlog and KEC’s ability to ramp-up execution, we expect revenue and earnings to clock CAGRs of 15% and 22%, respectively, over FY2019-FY2021E. We have fine-tuned our earnings estimates for FY2020-FY2021 factoring corporate tax rate cut. We reiterate our Buy rating on the stock with an unchanged price target (PT) of Rs. 325.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
KEC	12.0	10.2	6.6	5.9	2.4	2.0	21.6	21.8
L&T	19.3	16.8	14.1	12.5	2.8	2.5	15.2	15.7
KPTL	12.7	10.9	6.9	5.8	1.9	1.7	15.9	16.5

Source: Sharekhan Research

About company

KEC International is a Global Power Transmission Infrastructure EPC major. The company is present in the power T&D, cables, railways, renewable (solar energy), smart Infra and civil construction businesses. Globally, the company has powered infrastructure development in more than 61 countries. KEC is a leader in power transmission EPC projects and has more than seven decades of experience. Over the years, it has grown through the organic as well as the inorganic route.

Investment theme

T&D spends in India are expected to be around Rs. 2,300 billion over FY2018-FY2023E, up 28% over FY2012-FY2017. A large part of this spend is likely to come from state electricity boards. Additionally, ordering for the Green Energy Corridor is likely to provide ample opportunities in the domestic market. Moreover, expansion in regional transmission network in Africa, SAARC and CIS countries is likely to supplement domestic demand and present a large business opportunity. KEC has significantly scaled up the non-T&D segments (railways and civil segments) and margins in these segments have improved significantly. The opportunity size remains high in the non-T&D segment to provide enough opportunity to ramp up its total order outstanding for the business. KEC's order book remains strong, providing strong revenue visibility; and order inflow visibility remains healthy in international T&D and railways segments.

Key Risks

- ◆ Slower-than-expected execution of projects in domestic and international markets due to various reasons is expected to affect performance.
- ◆ Slowdown in tendering activities, especially in T&D, railways and overseas orders.

Additional Data

Key management personnel

Mr. Harsh Vardhan Goenka	Non-Executive - Non Independent Director-Chairperson
Mr. Vimal Kejriwal	Executive Director
Rajeev Aggarwal	Chief Financial Officer
Mr. Ajit Tekchand Vaswani	Non-Executive - Independent Director

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Swallow Associates Ltd	26.36
2	Summit Securities Ltd	10.86
3	HDFC Asset Management Co Ltd	9.31
4	Instant Holdings Ltd	8.49
5	Reliance Capital Trustee Co Ltd	4.00
6	Aditya Birla Sun Life Asset Manage	3.43
7	Kotak Mahindra Asset Management Co	2.84
8	IDFC Mutual Fund/India	2.32
9	STEL Holdings Ltd	1.95
10	Goenka Harsh Vardhan	1.89

Source: Bloomberg

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